4. Civil Defense Costs

a. Civil defense costs are those incurred in planning for, and the protection of life and property against the possible effects of enemy attack. Reasonable costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire fighting training and equipment, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the institution's premises pursuant to suggestions or requirements of civil defense authorities are allowable when allocated to all work of the institution.

b. Costs of capital assets under (a) above are allowable through depreciation or use charges in accordance with Item 6.

c. Contributions to local civil defense funds and projects are unallowable.

5. Compensation for Personal Services

a. Definition

Compensation for personal services includes all renumeration paid currently or accrued in whatever form and whether paid immediately or deferred for services rendered by employees of the institution during the period of contract performance. It includes, but is not limited to salary, wages, directors' and executive committee members' fees, bonuses, incentive awards, employee insurance, fringe benefits, and contributions to pension, annuity, and management employee incentive compensation plans.

b. Allowability

Except as otherwise specifically provided in this subsection, the costs of compensation for personal services are to be treated as allowable to the extent that:

(1) compensation is paid in accordance with policy, programs, and procedures that effectively relate individual compensation to the individual's contribution to the performance of contract work, resulting in internally consistent treatment of employees in like situations, and effectively relate compensation paid within the organization to that paid for similar services outside the organization;

(2) total compensation of individual employees is reasonable for the services rendered; and

(3) costs are not in excess of those costs which are allowable by the Internal Revenue Code and regulations thereunder.

c. Reasonableness

(1) In activities other than those sponsored by the Government, compensation for employees on Government sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the institution's other activities.

(2) When the institution is predominantly engaged in Government sponsored activities, and in cases where the kind of employees required for the Government sponsored activities are not found in the institution's other activities, compensation for employees on Government sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the institution competes for the kind of employees involved.

d. Review and Approval of Compensation of Individual Employees

In determining the reasonableness of compensation, the compensation of each individual employee normally need not be subject to review and approval. Reviews and approvals of individuals need be made only in those cases in which a general review reveals amounts or types of compensation which appear unreasonable or otherwise out of line.

e. Special Considerations in Determining Allowability

Certain conditions require special consideration and possible limitation as to allowability for contract cost purposes where amounts appear excessive. Among such conditions are the following:

(1) Compensation to shareholders, members, trustees, directors, associates, officers or members of the immediate families thereof, or to persons who are contractually committed to acquire a substantial financial interest in the enterprise.

Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs.

(2) Any change in an institution's compensation policy resulting in a substantial increase in the institution's level of compensation, particularly when it was concurrent with an increase in the ratio of Government awards to other business, or any change in the treatment of allowability of specific types of compensation due to changes in Government policy.

(3) The institution's activities are such that its compensation levels are not subject to the restraints normally occurring in the conduct of competitive business.

f. Unallowable Costs

Costs of compensation are not allowable to the extent that they result from provisions of labor-management agreements that, as applied to work in the performance of Government contracts are determined to be unreasonable either because they are unwarranted by the character and circumstances of the work or because they are discriminatory against the Government. The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (for example, work involving extremely hazardous activities or work not requiring recurrent use of overtime) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment, (for example, work involving less hazardous activities or work continually requiring use of overtime). It is discriminatory against the Government if it results in individual personnel compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances. Disallowance of costs will not be made under this subparagraph unless:

(1) the institution has been permitted an opportunity to justify the costs; and

(2) due consideration has been given to whether there are unusual conditions pertaining to the Government work which impose burdens, hardships, or hazards on the institution's employees, for which compensation that might otherwise appear unreasonable is required to attract and hold necessary personnel.

g. Special Requirements for Certain Compensation Costs

Certain forms of compensation are subject to the following requirements:

(1) Salaries and Wages

Salaries and wages for current services include gross compensation paid to employees in the form of cash, products, or services, and are allowable, except as provided in Item 14.

(2) Incentive Compensation

Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc. are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the institution and the employees before the services were rendered, or pursuant to an established plan followed by the institution so consistently as to imply, in effect, an agreement to make such payment. Awards, and incentive compensation when deferred are allowable to the extent provided in (3) below.

(3) Deferred Compensation

Deferred compensation includes all renumeration, in whatever form, for which the employee is not paid until after the lapse of a stated period of years or the occurrence of other events as provided in the plans, except that it does not include normal end of accounting period accruals for regular salaries and wages. It includes:

(a) contributions to pension and annuity plans;

(b) contributions to disability, withdrawal, insurance, survivorship, and similar benefit plans; and

(c) other deferred compensation.

Deferred compensation is allowable to the extent that:

(a) except for past service pension and retirement costs, it is for services rendered during the contract period;

(b) it is, together with all other compensation paid to the employee, reasonable in amount;

(c) it is paid pursuant to an agreement entered into in good faith between the institution and its employees before the services are rendered, or pursuant to an established plan followed by the institution so consistently as to imply, in effect, an agreement to make such payments;

(d) the benefits of the plan are vested in the employees or their designated beneficiaries and no part of the deferred compensation reverts to the employer institution;

(e) in the case of past service pension costs, it is amortized over a period of ten years or more; and

(f) for a plan which is subject to approval by the Internal Revenue Service, it falls within the criteria and standards of the Internal Revenue Code and the regulations of the Internal Revenue Services.

In determining the cost of deferred compensation allowable under the contract, appropriate adjustments shall be made for credits or gains, including those arising out of both normal and abnormal employee turnover, or any other contingencies that can result in a forfeiture by employees of such deferred compensation. Adjustments shall be made only for forfeitures which directly or indirectly inure to the benefit of the institution. Forfeitures which inure to the benefits of other employees covered by a deferred compensation plan with no reduction in the institution's costs will not normally give rise to an adjustment in contract costs. Adjustments for normal employee turnover shall be based on the institution's experience and on foreseeable prospects, and shall be reflected in the amount of cost currently allowable. Such adjustments will be unnecessary to the extent that the institution can demonstrate that its contributions take into account normal forfeitures. Adjustments for possible future abnormal forfeitures shall be effected according to the following rules:

(a) abnormal forfeitures that are foreseeable and which can be currently evaluated with reasonable accuracy, by actuarial or other sound computation shall be reflected by an adjustment of current costs otherwise allowable; and

(b) abnormal forfeitures, now within (a) above, may be made the subject of agreement between the Government and the institution either as to an equitable adjustment or a method of determining such adjustment.

In determining whether deferred compensation is for services rendered during the agreement period or is for future services, consideration shall be given to conditions imposed upon eventual payment, such as requirements of continued employment, consultation after retirement, and covenants not to compete.

(4) Fringe Benefits

Fringe benefits are allowances and services provided by the institution to its employees as compensation in addition to regular wages and salaries. Costs of fringe benefits, such as pay for vacations, holidays, sick leave, military leave, employee insurance, and supplemental unemployment benefit plans are allowable to the extent required by law, employer-employee agreement, or an established policy of the institution.

(5) Severance Pay

See Item 22.

(6) Training and Education Expenses

See Item 26.

(7) Location Allowances

"Location allowances," sometimes called "supplemental pay" or "incentive pay," are compensation in addition to normal wages or salaries and are paid by institutions to especially compensate or induce employees to undertake or continue work at locations which may be isolated or in an unfavorable environment. Location allowances include extra wage or salary payments in the form of station allowances, extended per diem, or mileage payments for daily commuting. They also include such benefits as institution-furnished housing. Payment of location allowances shall be allowed as costs under cost-reimbursement type contracts, or recognized in pricing fixed-price type contracts, only with prior approval in writing from the awarding agency and only where and so long as the isolation or unfavorable environment of the site make such payments necessary to the accomplishment of the work without unacceptable delays. Whether the site is so isolated, or its environment is so unfavorable, as to require location allowances is to be determined in the light of:

(a) its location and climate;

(b) the availability and adequacy of housing within reasonable commuting distance; and

(c) the availability and adequacy of educational, recreational, medical and hospital facilities.

The extent to which compensation includes allowances is to be determined by comparing it with:

(a) the institution's normal compensation policy, including pay scales at its principal operating locations;

(b) pay scales of other organizations and concerns operating at or near the site; and

(c) compensation paid by other concerns within the same field for similar services elsewhere.

Locations for which location allowances are paid shall be reviewed at least once a year to determine whether such allowances should continue to be allowed.

(8) Support of Salaries and Wages

Direct charges for professionals must be supported by either an adequate appointment and workload distribution system, accompanied by monthly reviews performed by an individual responsible for change in workload distribution of each professional (i.e., an exception reporting system) or a monthly after-the-fact certification system which will require persons in supervisory position having firsthand knowledge of the services performed to report the distribution of effort (i.e., a positive reporting system). Such reports must account for the total salaried effort of the persons covered. Consequently, a system which provides for the reporting only of effort applicable to federally sponsored activities is not acceptable.

Direct charges for salaries and wages of nonprofessionals will be supported by the time and attendance and payroll distribution records.

Allowable indirect personal services costs will be supported by the institution's accounting system maintained in accordance with generally accepted institutional practices. Where a comprehensive accounting system does not exist, the institution should make periodic surveys no less frequently than annually to support the indirect personal services costs for inclusion in the overhead pool. Such supporting documentation must be retained for subsequent review by Government representatives.

6. Depreciation and Use Allowances

a. Institutions may be compensated for the use of buildings, capital improvements and usable equipment on hand through depreciation or use allowances. Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life has reference to the prospective period of economic usefulness in the particular institution's operations as distinguished from physical life. Use allowances are the means of allowing compensation when depreciation or other equivalent costs are not considered.

b. Depreciation or a use allowance on assets donated by third parties is allowable. However, any limitation on the amount of depreciation which would have applied to the donor as a result of restrictions contained in this Section shall also apply to the recipient organization.

c. Due consideration will be given to Government-furnished facilities utilized by the institution when computing use allowances and/or depreciation if the Government-furnished facilities are material in amount. Computation of the use allowance and/or depreciation will exclude the cost of grounds and buildings and equipment borne by or donated by the federal/state/local Government, irrespective of where title was originally vested or where it presently resides. Capital expenditures for land improvements (paved areas, fences, streets, sidewalks, utility conduits, and similar improvements not already included in the cost of buildings) are allowable provided the systematic amortization of such capital expenditures has been provided in the institution's books of account, based on reasonable determinations of the probable useful lives of the individual items involved, and the share allocated to the contract is developed from the amount thus amortized for the base period involved.

d. Normal depreciation on an institution's plant, equipment, and other capital facilities is an allowable element of cost provided that the following conditions exist:

(1) The depreciation must be computed upon a property cost basis which could have been used by the institution for Federal Income Tax purposes, had such institution been subject to the payment of income tax.

(2) By the consistent application to the assets concerned of any generally accepted accounting method, and subject to the limitations of the Internal Revenue Code of 1954 as amended, including:

(a) the straight line method;

(b) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in (a) above;

(c) the sum-of-the-years-digits method; and

(d) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the use of the property and including the current year, does not during the first two-thirds of the useful life of the property exceed the total of such allowances which would have been used had such allowances been computed under the method described in (b) above.

(3) Adequate property records must be maintained. The period of useful service (service life) established in each case for useable capital assets must be determined on a realistic basis which takes into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular area, and the renewal and replacement policies followed for the individual items or classes of assets involved. Where the depreciation method is introduced for application to assets acquired in prior years, the annual charges therefrom must not exceed the amounts that would have resulted had the depreciation methods been in effect from the date of acquisition of such assets.

(4) The depreciation costs must be actually recorded and accounted for on the institution's published financial statements.

e. When the use allowance method is followed, the use allowance for buildings and improvements will be computed at an annual rate not exceeding 2 percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding 6 2/3 percent of acquisition cost of usable equipment in those cases where the institution maintains current records with respect to such equipment on hand. Where the institution's records reflect only the cost (actual or estimated) of the original complement of equipment, the use allowance will be computed at an annual rate not exceeding 10 percent of such cost. Original complement for this purpose means the complement of equipment initially placed in buildings to perform the functions currently being performed in such buildings; however, where a permanent change in the function of a building takes place, a redetermination of the original complement of equipment may be made at that time to establish a new original complement. In those cases where no equipment records are maintained, the institution will justify a reasonable estimate of the acquisition cost of usable equipment which may be used to compute the use allowance at an annual rate not exceeding 6 2/3 percent of such estimate.

f. When the depreciation method is used for a particular class of assets, no depreciation, rental or use charge may be allowed on any such assets that would be viewed as fully depreciated. However, a reasonable use charge may be negotiated for any such assets if warranted after taking into consideration the cost of the facility or item involved, the estimated useful life remaining at time of negotiation, the actual replacement policy followed in the light of service lives used for calculating depreciation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the facility or item for the purpose contemplated.

g. When a facility is sold, the revaluation of that facility often increases reimbursement for capital-related costs. The Department will limit the increase in capital-related reimbursement associated with the sale or transfer of real property, if the facility was previously used for a Department of Human Services program, and the owner was reimbursed for depreciation expense. The Department must ensure that state and federal funds are not used to pay for the same asset more than once. Therefore, reimbursement for capital-related costs to the new owner must be based on the historical cost (the cost to the original owner) or the purchase price, whichever is less.

(1) Reimbursement for depreciation expense must be based on the acquisition of the asset as entered on the books and records of the prior owner less any depreciation taken on the asset by the prior owner.

(2) The new owner's capital-related costs must be determined by using the same useful life and method of depreciation as used by the prior owner for reimbursement by the Department.

(3) The Department recognizes that the limitation on reimbursement of capital-related costs of revalued facilities may be circumvented by certain sale/leaseback or sale-rental agreements. The Department must determine the reasonableness of any lease and rental costs involving a depreciable asset which has undergone a change in ownership.

h. Depreciation or use charges on idle or excess facilities shall not be allowed except on such facilities as are reasonably necessary for standby purposes. (See Section 3.6, Item 6).

i. Depreciation and/or use charges should usually be allocated to all activities as an indirect cost.

7. Employee Morale, Health, Welfare Costs, and Credits

a. Employee morale, health and welfare activities are those services or benefits provided by the institution to its employees to improve working conditions, employer-employee relations, employee morale, and employee performance. Such activities include house publications, health or first-aid clinics, recreation, employee counseling services and, for the purpose of this paragraph, food and dormitory services. Food and dormitory services include operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations, or similar types of services for the institution's employees at or near its facilities.

b. Except as limited by c. below, the aggregate of costs incurred on account of all activities mentioned in a. above, less income generated by all such activities is allowable to the extent that the net amount is reasonable.